

RACE AND THE FEDERAL INCOME TAX: HAS A DISPARATE IMPACT CASE BEEN MADE?

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I. INTRODUCTION

A. *The Moran and Whitford Argument*

Professors Moran and Whitford's *A Black Critique of the Internal Revenue Code*¹ is a straightforward and plausible application of "critical race theory" to the United States federal income tax. Their argument proceeds essentially as follows: (a) African-Americans differ from the white majority in several important socioeconomic respects; (b) the U.S. Congress, being dominated by members chosen from and by the white majorities that prevail in most states and congressional districts, is likely to write an Internal Revenue Code ("I.R.C.")² with the characteristics of the white population primarily in mind; from which it (almost) follows that (c) the I.R.C. in fact produced by the last several dozen Congresses probably discriminates against African-Americans. The authors' examination of what they admit is partial evidence on this subject tends to confirm the hypotheses suggested by the logical chain described.

I do not question the underlying insights of critical race theory as Moran and Whitford describe them. Even if it can be assumed that most members of Congress are well-intentioned and make some effort to represent the interests of all of their constituents, it seems likely that the interests of African-Americans—and of every other

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1. Beverly I. Moran & William Whitford, *A Black Critique of the Internal Revenue Code*, 1996 WIS. L. REV. 751. As will become clear, this Reply is directed primarily at the Moran and Whitford article cited. I have also read—primarily to avoid unnecessary duplication of arguments offered there—a draft of Professor Zelenak's critique of the *Wisconsin Law Review* article (among others), see Lawrence Zelenak, *Taking Critical Tax Theory Seriously*, 76 N.C. L. REV. 1521 (1998), as well as drafts of Moran and Whitford's separate replies.

2. Though many tax writers, including Moran and Whitford, speak loosely of "the Internal Revenue Code," the discussion in their article and in this Reply relate exclusively to the personal income tax provisions of the Code.

minority, for that matter—would be less well-served than the interests of their majority counterparts. This underrepresentation is an aspect of democracy that, as a member of the white majority, I accept as inevitable, but which would no doubt persistently infuriate me if I were not.

B. My Initial Response

Be that as it may, the Moran and Whitford argument is not quite syllogistic, if only because Congress sometimes does things by accident. Or, more precisely, Congress sometimes creates unintended benefits for one group of Americans as a by-product of acts intended to achieve some other goal that it more consciously seeks. And it seems to me that that phenomenon is in fact a reasonably accurate characterization of the federal income tax as it relates to African-Americans. In fact, when I first read the article, my mind was headed down a track quite different from the authors', which I can summarize with the following competing chain of observations: (a) by far the most salient socioeconomic characteristic for purposes of assessing income tax burdens is income itself; (b) African-Americans are dramatically underrepresented in high- and middle-income groups and overrepresented in the lowest income groups; (c) our personal income tax, whatever its faults, is in the end significantly progressive; from which it follows that (d) despite the details of the tax situations Moran and Whitford analyze, the bottom-line arithmetic of tax burdens must surely and substantially favor African-Americans.³ One looks in vain for even the barest acknowledgement of this possibility in their article.

3. Of course, any statement to the effect that any group is favored or disfavored by a rule or system of rules always raises the normative question: "Compared to what?" I have no better answer to that than anyone else does, but I mean here to assert that African-Americans likely bear smaller overall federal income tax burdens than white taxpayers do, whether measured in absolute terms or as a percentage of their incomes. A full statistical proof of this assertion is beyond the scope of this Reply. However, to give the reader some sense of the quantitative aspects of this problem, it can be noted that fully 55.5% of the total federal income tax paid in 1994 was paid by taxpayers whose adjusted gross incomes exceeded \$75,000 in that year. By contrast, only about 0.5% of the total tax collected was paid by taxpayers with adjusted gross incomes of \$10,000 or less. See INTERNAL REVENUE SERV., U.S. DEP'T OF THE TREASURY, INDIVIDUAL INCOME TAX RETURNS 1994, at 31 tbl.1.1 (1997). In 1994, about 15.6% of white households had money incomes exceeding \$75,000, but only 6.8% of black households were in this category. On the other hand, 26.1% of black households had money incomes of less than \$10,000, while only 11.3% of white households were in this category. See BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES: 1997, at 465 tbl.717 [hereinafter STATISTICAL ABSTRACT].

C. Horizontal Versus Vertical Equity

I actually think that both lines of analysis are generally correct, yet they somehow fail to meet head-on in a way that resolves the apparent paradox. This failure is largely because the two lines are premised on fundamentally different standards of equity: Moran and Whitford are for the most part discussing what is generally referred to as “horizontal equity”—which demands that taxpayers who are similarly situated, in terms of characteristics that are appropriately cognizable, be treated similarly by the rules of the tax code. My armchair response reflected an intuitive sense that any horizontal inequities in the current income tax system with respect to black-white differentials are swamped by much more powerful “vertical equity” aspects that significantly (albeit accidentally) favor African-Americans. Vertical equity is inevitably somewhat subjective and does not lend itself to definitional crispness in the way that horizontal equity does. But vertical equity generally refers to the notion that the burdens of supporting the government should be apportioned according to ability to pay, and that those who are relatively well-off, however that is measured, should bear heavier tax burdens than those who are not.⁴

I note in passing that Moran and Whitford did not make as clear as they might have that they were engaged exclusively in a horizontal equity analysis. They do indicate in an early footnote that their analysis is couched in terms of horizontal equity.⁵ But only a few pages later, they offer observations that appear to indicate that they mean to discuss both types of equity.⁶ Moreover, some of the proposed solutions they offer to the tax rules they find objectionable have a distinctly vertical equity flavor.⁷

4. Note that a vertically equitable tax system need not necessarily be a progressive one. Vertical equity considerations suggest that higher *absolute* tax burdens should be assessed on taxpayers with higher incomes (or more wealth, or whatever), but those considerations do not necessarily dictate that those taxes must represent higher *proportions* of that income (or wealth), which is the usual definitional requirement of a progressive tax.

5. See Moran & Whitford, *supra* note 1, at 753 n.10.

6. See *id.* at 756-57 (“[W]e had to decide whether we were interested solely in the differential impact of tax benefits by race, or whether we were interested in the differential impact by race after controlling for income We decided that we were interested in both.”). The first of these analyses, by *not* controlling for income, would necessarily involve a blend of horizontal and vertical equity considerations. The second would be targeted primarily at horizontal equity issues.

7. For example, they proposed that the current deductions for home mortgage interest and real property taxes be replaced by credits that are phased out once adjusted gross income on a joint return exceeds \$50,000. See *id.* at 781. But the difference in effect

Despite occasional confusion on this point, however, it does seem clear enough that Moran and Whitford are mostly concerned with horizontal equity, while my initial response was mostly based on vertical equity considerations. What if both lines of analysis are indeed well-founded? That is, suppose that it is true that our tax system contains horizontal equity defects that disadvantage African-Americans, but that the tax system nevertheless treats African-American taxpayers more favorably overall than white taxpayers, in the sense of assessing lower average tax rates on them because of the lighter burdens assigned generally to lower-income taxpayers.⁸ What should one make of such a system?

In the context of an academic analysis, this is not a difficult question. Surely African-Americans—like any other taxpayers—are entitled to a tax system that reasonably satisfies both standards of equity. From an overall policy perspective, it is entirely appropriate to say that both forms of equity are essential and that achievement of one sort of equity is never an adequate substitute for the highest practicable achievement of the other. To put it more concretely in terms of this debate, the prevailing sense of vertical equity appears to reflect the view that low-income taxpayers should hardly be subject to the income tax at all and that middle-income taxpayers should be subject only to relatively light taxation. This is a policy that is presumably not influenced to any significant degree by considerations of race. If African-Americans turn out to be the beneficiaries of such a view, it is because they are relatively poor, not because they are black. It remains true that, to the degree that

between a deduction and a credit is determined by differences in marginal tax rates, which generally do not exist in horizontal equity analyses, since the comparison in such an analysis is between taxpayers with equal incomes. Only if one contrasts high-income, high-tax-rate individuals with lower ones—a quintessentially vertical equity analysis—does their prescription make any sense.

8. I should note that Moran and Whitford would apparently not concede my point to the effect that the vertical equity aspects of the federal income tax favor African-Americans. In the same paragraph quoted *supra* in note 6, they add: "It is commonly assumed that blacks cluster in the lower economic classes, and that most tax benefits favor the wealthy more than the poor. If these assumptions are correct, it follows that tax benefits in the Internal Revenue Code directly benefit whites as a group more than blacks." Moran & Whitford, *supra* note 1, at 757. If the argument that "most tax benefits favor the wealthy" is based on the notion that a particular deduction is worth more to higher-bracket taxpayers than to lower ones, then it has the absurd quality of making graduated rates the enemy of the poor. A tax system like our present one, but without standard deductions, personal exemptions, or graduated rates, would be one in which a dollar of deduction produced the same benefit for every taxpayer, but it would certainly not represent an improvement in vertical equity in my view, nor, I expect, in the view of Moran and Whitford.

African-Americans do rise above the lower ranks of the economy, they are entitled to the benefits of horizontally equitable tax laws.

D. The Broader Context of Tax Reform

However, this analysis ignores an important aspect of the current political context. Moran and Whitford compare the existing I.R.C. with what might have been drafted by a hypothetical "Black Congress."⁹ This comparison is fair enough, and even conveys a clever didactic point. However, the United States is currently engaged in a broad discussion of what sort of tax system it should have going into the next century, and the range of alternatives to the income tax being seriously considered consists largely of one or another form of a consumption tax, not the ideal income tax as it might be envisaged by a black Congress.

The debate that Moran and Whitford have started over the racial impact of the income tax is important in part because one of the co-authors, Beverly Moran, is one of the two or three most prominent African-American commentators on tax issues. Her thoughts on the subject are likely to be influential with other black opinion leaders and decision-makers. I could easily imagine that black readers of Moran and Whitford's article might conclude that black support of the current system is not merely unnecessary, but virtually constitutes their cooperation in a continuing act of racial oppression. This view would make enactment of something like a flat tax, or a national value-added tax, marginally more likely.

How might such an alternative tax affect African-Americans? Unfavorably, I think. That is so because lower-income households generally consume a larger proportion of their incomes than higher-income households do, so a shift in the base of our main tax from income to consumption will generally tend, all else being equal, to shift burdens toward those lower-income households, including the disproportionate number of black households falling into that class. That tendency would likely be exacerbated as to racially disparate outcomes in the United States, for the very reasons that inform Moran and Whitford's analysis: Even holding income constant, blacks have a greater propensity to "save" by investing in consumer durables,¹⁰ which would likely be treated simply as consumption under most consumption tax plans. A detailed analysis of how blacks

9. See Moran & Whitford, *supra* note 1, at 758.

10. See *id.* at 770 (noting that, compared to whites, blacks hold a greater percentage of their wealth in vehicles).

would fare under one or more of the heavily promoted consumption taxes, compared to how they fare under the current income tax, would have been most welcome. As I noted above, I think such an analysis would produce the conclusion that the income tax, whatever its faults, is indeed much friendlier to blacks than anything Congress is likely to enact in its stead.¹¹

But I note all these things mostly as an aside; it is usually unwise and always unfair to criticize authors for not writing the article that the critic wishes they had written. It is fair, however, to ask whether the authors have made the case they chose to make. Is a reader at least tentatively persuaded by their analysis that the current federal income tax is horizontally inequitable in its treatment of African-American taxpayers? I will discuss this question by looking first at their choice of the tax rules included in their study, and then at the substance of their discussion of several of those rules.

II. SELECTION OF RULES TO BE STUDIED

Moran and Whitford recognize the difficulty of proving very much with the methods they have chosen.¹² The I.R.C. is huge and messy, and the authors begin their discussion by noting that even provisions that appear narrowly technical—such as the income-averaging rules that were effective from 1964 through 1986—may have racially disparate consequences.¹³ So everything is potentially

11. While this seems likely, it is far from certain. Some proposals that reduce progressivity at the top end also would increase exemption levels, which might have the net effect of lowering average tax burdens of African-Americans. For example, the Hall-Rabushka version of the flat tax would impose a 19% rate on wage income in excess of \$25,500 for a family of four. See ROBERT E. HALL & ALVIN RABUSHKA, *THE FLAT TAX* at vii (2d ed. 1995). Because Hall and Rabushka propose a number of changes in income definition and business taxes that would have to be accounted for, comparison with the present system is difficult. In the present context, repeal of the refundable earned income credit would have an important effect. However, superficial comparison with the present rate charts, which would tax the income of a family of four in excess of \$17,500 (the sum of the joint-filer standard deduction, plus four personal exemptions, for the 1997 tax year) at rates beginning at 15%, would suggest that families with incomes below \$30,000 who now have positive income tax burdens might well have lower direct tax burdens under the flat tax.

12. See Moran & Whitford, *supra* note 1, at 754.

13. Indeed, the authors say that their study was initiated partly in response to a question posed rhetorically by a tax professor (who was in fact I) to a black colleague: "Is there a black view on income averaging?" See *id.* at 752. Moran and Whitford conclude, contrary to the assumption of the rhetorical question, that there would be such a view: that it is not very important to blacks, because they are infrequently found in the higher brackets. See *id.* at 752-53. I would note for the record that, at least under the present rate structure, middle-income taxpayers are in fact quite vulnerable to penalties associated with income fluctuation, since the rate bracket steps from zero to 15, and from

relevant, and “everything” covers a lot. They could not consider literally everything though, and so necessarily made some choices. How did they select the particular rules they studied? They do not answer this question directly; they only indicate that the provisions they studied are “some of the most significant.”¹⁴ It is clear as well that the choices were shaped to some degree by the availability of data.

The magnitude of the data difficulties and the impossibility of producing a comprehensive analysis of all potentially relevant factors in assessing the disparate impact of the I.R.C. are easy to appreciate. Indeed, the very facial neutrality of the I.R.C., which means among other things that no one—not even the IRS itself—knows the race of any particular taxpayer, is a large part of the statistical challenge Moran and Whitford faced in performing their research. That they managed to develop and implement a reasonable research methodology of any sort is commendable. Nevertheless, their failure to specify some sort of rule-selection principles at the outset leaves them vulnerable to the criticism that they have rigged the study by choosing features of the I.R.C. that would make their point and omitting features that might tend in the opposite direction. Any reader who has even minimal information about the I.R.C. can readily summon to mind several provisions—such as the earned income credit, or even the graduated rate structure itself¹⁵—which would appear to favor black taxpayers, but have indeed been omitted from the study.

15 to 28, are quite steep, and the brackets themselves relatively narrow. As one moves up the rate structure, the rate steps are smaller and more widely spaced. Thus, middle-income taxpayers experiencing a particular percentage income fluctuation over a multi-year period are more likely to cross bracket boundaries, and hence more likely to be penalized, than taxpayers in the highest brackets would be for similar percentage fluctuations. Of course, while this argument suggests that their specific conclusions about income averaging may have been too hasty, it also tends to reinforce their larger point, which is that any important tax rule may have some racially disparate effect, even if that effect is not facially evident.

14. *See id.* at 800.

15. The earned income credit allows a refundable credit for taxpayers based on the amount of their earned income. Through income-based phase-out rules, the benefits of this provision are limited to relatively low-income taxpayers. For the 1998 tax year, taxpayers with incomes over \$30,095 will not generally be eligible for any earned income credit; lower limits would apply if the taxpayer has fewer than two qualifying children, and no credit at all may be taken if the taxpayer has more than a modest amount of investment income (\$2300 in 1998), or fails to meet any of a number of other restrictions on eligibility. *See* I.R.C. § 32(b)(1), (b)(2) (West Supp. 1998) (setting forth phase-out parameters which are updated annually pursuant to I.R.C. § 32(j)); Rev. Proc. 97-57, 1997-52 I.R.B. 20, 22 (providing 1998 parameters).

However, upon further reflection, two reasons emerge to remove suspicion that the study has been flawed by unprincipled selection of its subjects. First, many of the omissions that may seem to taint the study are in fact ambiguous in their impact on the authors' conclusions, for reasons related to the discussion above regarding horizontal versus vertical equity considerations. For example, it is far from clear that the earned income credit particularly favors black taxpayers *when income is held constant*, as it of course should be in a proper assessment of horizontal equity. Black families with adjusted gross incomes of, say, \$20,000, are not eligible for any larger credits than comparable white families. Indeed, because the credit is based on *earned* income (meaning essentially income from labor), it is entirely possible that higher black unemployment rates would lead to the conclusion that this provision actually disadvantages blacks as a group at any given income level, since the sources of their incomes may be somewhat less likely to qualify them for this credit. Similarly, any disparate impact analysis of the graduated rate structure is beside the point if the analysis is confined to horizontal equity, under which all comparisons are among taxpayers with equal incomes and, hence, equal tax rates.

Second, it seems likely that Moran and Whitford really did select, for the most part, tax provisions that have the greatest impact on tax liability. That assertion is not subject to conclusive proof or falsification, but it is instructive to compare the list of provisions examined by Moran and Whitford with the list of "tax expenditures"—ranked by the revenue loss that each provision was expected to produce in this fiscal year (Fiscal Year 1998)—prepared by the Office of Management and Budget in connection with the submission of the proposed budget last January.¹⁶ By my count, Moran and Whitford examined nine items that appeared on the tax expenditure budget.¹⁷ The Moran and Whitford list included all four

16. See BUDGET OF THE UNITED STATES GOVERNMENT—ANALYTICAL PERSPECTIVES, FISCAL YEAR 1998, at 79 tbl.5-3 (1997) [hereinafter 1998 BUDGET] (providing data on "Major Tax Expenditures in the Income Tax, Ranked by Total 1998 Revenue Loss").

17. Those items were the following, with references to the point at which they appeared in the Moran and Whitford article: the stepped-up basis at death rules of I.R.C. § 1014, *see* Moran & Whitford, *supra* note 1, at 760-61; the preferential capital gains rates provided by I.R.C. § 1(h), *see id.* at 761-62; the home mortgage interest deduction under I.R.C. § 163(h), *see id.* at 774-75; the residential property tax deduction under I.R.C. § 164, *see id.*; the opportunity to roll over capital gains on personal residences in I.R.C. § 1034, *see id.* at 773-74; the opportunity to exclude up to \$125,000 of gains on the sale of a personal residence by a taxpayer over age 55 under I.R.C. § 121, *see id.*; the exclusion of health insurance premiums paid by an employer under I.R.C. § 106, *see id.* at 783-86; the

of the largest items on that list, and consisted exclusively of items drawn from the top twenty revenue-losers.¹⁸ Perhaps more to the

deductibility of IRA contributions under I.R.C. § 219, *see id.* at 755, 783-86; and the deferral of taxability of pension plan and Keogh plan distributions under I.R.C. § 401, *see id.* at 784-86. (Note that several of these provisions were repealed or altered by the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, 1997 U.S.C.A.N. (111 Stat.) 788. For example, section 312(a) of the act amended I.R.C. § 121, and section 312(b) of the act repealed I.R.C. § 1034 generally for sales after May 5, 1997. Also, several sections of the act, section 302 for example, expanded the availability of the tax-favored individual retirement accounts, which will doubtless increase the tax expenditures associated with such accounts. However, the provisions in question were effective for purposes of budget estimates in January 1997 under substantially the same terms that applied at the time of the Moran and Whitford study.).

18. The following is the list of "tax expenditures" in the 1998 budget:

Major Tax Expenditures in the Income Tax, Ranked by Total 1998 Revenue Loss

Provision	Revenue Losses, in \$ millions	
	1998	1998-2002
Exclusion of employer contributions for medical insurance premiums and medical care	75,750	435,745
Net exclusion of employer pension-plan contributions and earnings	56,245	285,445
Deductibility of mortgage interest on owner-occupied homes	52,115	284,790
Step-up basis of capital gains at death	31,945	173,040
Deductibility of nonbusiness State and local taxes other than on owner-occupied home	30,995	169,370
Accelerated depreciation of machinery and equipment (normal tax method)	29,285	175,965
Deductibility of charitable contributions	22,340	123,365
Exclusion of OASI benefits for retired workers	18,495	100,345
Deductibility of State and local property tax on owner-occupied homes	17,435	95,285
Exclusion of interest on public purpose State and local debt	15,735	77,245
Deferral of capital gains on home sales	15,290	81,165
Deferral on income on life insurance and annuity contracts	11,940	67,975
Exclusion of interest on State and local debt for various non-public purposes	8,925	42,450
Net exclusion of Individual Retirement Account contributions and earnings	8,600	45,465
Capital gains (other than agricultural, timber, iron ore, and coal) (normal tax method)	8,480	45,010
Earned income credit	5,814	31,725
Exclusion of workmen's compensation benefits	5,305	29,590
Exclusion of capital gains on home sales for persons age 55 and over	5,095	27,210
Graduated corporation income tax rate (normal tax method)	4,940	27,165
Accelerated depreciation of buildings other than rental housing (normal tax method)	4,660	13,190

point, the larger tax expenditure items that they did *not* examine do not appear to be ones having obvious horizontal equity features that would favor African-Americans.¹⁹ For example, the fifth-ranked item is the deductibility of state and local personal taxes other than property taxes.²⁰ This category would consist primarily of state income taxes, which are assessed according to income, and thus likely to satisfy horizontal equity concerns reasonably, with no racially disparate effect running in either direction.²¹ Similarly, the next several items, which involve accelerated depreciation, charitable contributions, and exclusion of retirement benefits, do not obviously favor blacks when income is held constant.

Thus, though my own initial reaction on reading the Moran and Whitford article was that their tentative disparate impact results were significantly enhanced by conscious or unconscious choices they had made in constructing the field of study, it seems upon closer scrutiny that such a suggestion may not be warranted.²²

III. SUBSTANTIVE HORIZONTAL EQUITY ANALYSIS

Moran and Whitford examined rules in four broad categories: wealth and wealth transfer,²³ home ownership,²⁴ employee benefits,²⁵ and filing status.²⁶ They found significant horizontal equity shortcomings in each, uniformly to the disadvantage of African-Americans. In my view, their analysis as to the second and third categories is generally correct, but serious omissions in their analyses of the first and fourth categories cast doubt on their conclusions. I

See 1998 BUDGET, *supra* note 16, at 79 tbl.5-3. Also, though the earned income credit shows up in rank 16, that is because this table looks only at revenue losses from uncollected taxes. The earned income credit program also involves direct expenditures this year of about \$22 billion, *see id.* at 80 n.1, which, together with the revenue foregone, would make that provision the seventh most expensive tax provision for the current year.

19. Unless, of course, a reader disagrees with my off-hand analysis of the earned income credit.

20. *See* 1998 BUDGET, *supra* note 16, at 79 tbl.5-3; *supra* note 18 (setting forth figures).

21. Of course, state income tax rates vary, and so does the percentage of state population that is black; so there is probably some modest disparate effect. However, I do not think it would be very large, and I do not even have a clear intuition about which direction any advantage might run.

22. A possible exception relates to their discussion of the so-called "marriage penalty," discussed *infra* in Part III.C. Dealing with this aspect of filing status without consideration of the broader questions in this area seems to me an inappropriate choice.

23. *See* Moran & Whitford, *supra* note 1, at 759-72.

24. *See id.* at 773-83.

25. *See id.* at 783-91.

26. *See id.* at 791-99.

will discuss each of these categories briefly below.

A. *Wealth and Wealth Transfer*

Moran and Whitford analyzed four features of the tax treatment of wealth and wealth transfers in this first and longest section of detailed analysis: that the receipt of property by gift or inheritance in the first instance is not a taxable event under the federal income tax;²⁷ that accrued gains are not taxed until realized;²⁸ that such gains may never be taxed if the holder of the property dies without having realized those gains;²⁹ and that even if the gains are realized, they may be taxed at more favorable rates than apply to other forms of income.³⁰ Their argument is, basically, that African-Americans are, *at any given income level*, less likely to receive property by gift or inheritance and less likely to have investments of a sort that generate appreciation in value that can benefit from the favorable rules on realization and capital gain.³¹

1. Exclusion of Gifts and Inheritances

Accepting their evidence on the racially disparate receipt of property by gift or inheritance, deep conceptual problems remain in their assumption that these things are appropriate for inclusion in income. Taxing the receipt of gifts or inheritances without allowing a deduction to the donor or decedent raises a double-counting problem of serious proportions. If receipt of a gift yields an "accession to wealth, clearly realized" under the *Glenshaw Glass* income definition³² that Moran and Whitford use, then it is equally clear that a decrement to the wealth of the donor simultaneously occurs. The tax rules could be amended both to require inclusion by the donee and to allow a deduction by the donor of gifts, but since most large gifts are thought to proceed from higher-bracket taxpayers to lower-bracket taxpayers, this amendment would reduce aggregate tax revenue and presumably exacerbate any racially disparate effects of this part of the tax system.

A superficially similar double-counting may be thought to take place when, for example, A pays B for the latter's service to A as a

27. *See id.* at 762-63.

28. *See id.* at 759-60.

29. *See id.* at 760-61.

30. *See id.* at 761-62.

31. *See id.* at 768-72.

32. *See Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 431 (1955); Moran & Whitford, *supra* note 1, at 753 (citing *Glenshaw Glass* and its definition of income).

butler. A gets no deduction, and B clearly has income. In that case, however, the payment represents consumption by A of butler services. Since the comprehensive tax base approach to income accounting defines income as the sum of wealth changes and consumption within a time period, it can be seen that consuming services and paying for them are transactions that cancel, leaving income unchanged and providing no basis for a deduction by A.

It has been argued that if A makes a gift to B, A also could be said to have consumed that amount.³³ Gift giving has always seemed to me an odd form of consumption, however. It uses no resources, and failure to make the gift in question would free no resources for alternative uses—unlike failing to hire B as a butler, which would free B to sell his labor elsewhere.

My argument on this point can perhaps be best summarized by asking if A and B are, taken together, any better off when A makes a gift to B. They probably are better off in a psychological sense: B is gratified to receive the gift, and A must take pleasure in benefiting B, or the gift would not have been made. However, psychic benefits are not usually accounted for by tax rules; A and B might also be better off if they kissed or embraced, but that is not something with which we want the tax system to deal. In purely economic terms, the gift has not improved their situation; taken together, B's increased consumption opportunities are precisely offset by A's decreased consumption opportunities. In that view, gifts are a mere transfer of consumption opportunities, not consumption in itself.

Finally, I would note that gifts contribute nothing to the gross domestic product and national income accounts. Nor are the exclusions of gifts counted as part of the tax expenditure budget.

As indicated in the notes to the foregoing, this view of gifts is not universal.³⁴ Moran and Whitford can certainly find support for their view that gifts should be included in income, with or without a deduction for the donor. But since there is no widely shared

33. Indeed, Henry Simons makes such an argument in his 1938 treatise *Personal Income Taxation*, which is, of course, the fountainhead of the comprehensive tax base idea. See HENRY C. SIMONS, *PERSONAL INCOME TAXATION* 139-40 (1938).

34. Simons, referenced *supra* in note 33, would presumably endorse Moran and Whitford's approach. Others are generally more equivocal, with some indicating that income taxation of gifts may be a good idea, but only as a substitute for wealth transfer taxes. See, e.g., Joseph M. Dodge, *Beyond Estate and Gift Tax Reform: Including Gifts and Bequests in Income*, 91 HARV. L. REV. 1177 (1978). The purpose of wealth transfer taxes, of course, is to reduce economic inequality, an idea that concerns exclusively vertical equity and has no relevance to horizontal equity concerns of the sort discussed by Moran and Whitford.

agreement that gifts should be included in income, there can be no agreement that the failure to do so constitutes an equitable shortcoming of any kind.

2. Other Capital Taxation Rules

Moran and Whitford's other arguments regarding treatment of returns from capital investment enjoy much broader support from the tax policy literature. No tax expert would defend the exclusion of capital gains at death, nor the realization requirement,³⁵ on any grounds other than the administrative inconvenience of rules to the contrary. Capital gains rate preferences are similarly unpopular among tax policy experts.³⁶

Even this solid ground gives way a bit, however, when Moran and Whitford conclude that black taxpayers are disadvantaged by their tendency to invest in inner-city housing and consumer durables, rather than in assets with significant appreciation potential, like stock and commercial real estate.³⁷ For while the tax system does indeed lightly tax the latter categories of assets, it fails to tax at all the returns on investments in consumer durables. Suppose, for example, that a taxpayer with \$20,000 is deciding whether to buy an automobile or to lease the automobile and buy a financial asset with the \$20,000. If he buys the automobile, he will be spared the (nondeductible) cost of leasing the automobile, an amount which represents the gross return on his investment in that asset.³⁸ He might be able to defer or even to avoid taxation on the returns on the

35. Moran and Whitford's choice of *Glenshaw Glass* as their baseline definition of income seems especially odd in light of their criticism of the realization requirement, which the Supreme Court in that case seemed to accept without pause when it spoke of "accessions to wealth, *clearly realized*." *Glenshaw Glass*, 348 U.S. at 431 (emphasis added). Nevertheless, most other descriptions of the comprehensive tax base recognize the failure to tax gains as they accrue as a major shortcoming.

36. So-called "supply-side" economists defend preferential capital gains rates on grounds of their supposed stimulative effects, but not because of the conceptual soundness of such lowered rates. See, e.g., LAWRENCE LINDSAY, *THE GROWTH EXPERIMENT* 46, 229 (1990). I have argued elsewhere that lower capital gains rates might be justified on grounds that the distortions induced by such rates offset distortions induced by the realization requirement itself. See Richard L. Schmalbeck, *The Uneasy Case for a Lower Capital Gains Tax: Why Not the Second Best?*, 48 TAX NOTES 195 (1990).

37. See Moran & Whitford, *supra* note 1, at 769-71.

38. His net return would be that amount, less a reasonable allowance for depreciation of the asset. The lease payments would ordinarily be expected to equal this depreciation allowance, plus the lender's cost of the capital it invested in the car. Thus, the net investment returns to a consumer who buys a car should approximate the general rate of return on invested capital in the economy at the time of the purchase.

financial asset he might buy, but he will definitely and automatically avoid taxation on any return on the investment in the consumer durable.

Although I regard the foregoing as serious shortcomings in Moran and Whitford's arguments, I must concede the larger point that they make as to this category of tax rules: The federal income tax—as written and as enforced³⁹—contains serious defects in taxation of income from capital, most of which result in the undertaxation of such income.⁴⁰ Moran and Whitford make a convincing case that, as a whole, at any given income level, African-Americans have less capital than white taxpayers⁴¹ and hence enjoy lesser benefits from the lighter tax burdens on income from that source. In other words, one of their substantial points continues to carry weight even if they were to concede that I was correct in challenging their analysis of the exclusion of gifts and inheritances and of the disparate impact of the tax rules regarding financial assets and consumer durables.

B. Home Ownership and Employee Benefits

I consider the two major categories of home ownership and employee benefits together because my commentary on them is similar and brief. Although a few quibbles can be raised here and there, Moran and Whitford have generally made their points as to the tax rules in these categories. Congress has intentionally departed from accepted definitions of income in order to encourage home ownership, pension savings, and health insurance. Both Congress's motives and its effects in these areas are mostly benign, but, at least as to the first two of this list, an incidental effect appears to have been that, at any given income level, African-Americans have enjoyed disproportionately lesser benefits.⁴²

What exactly should be done about this effect perplexes me, as it clearly did Moran and Whitford themselves. The ends Congress has

39. I refer here to the fact that income from wages is generally easy to find, and hence to tax, while income from capital can be more elusive. Such income can consist of, to cite one example, interest on a foreign bank account that is beyond the discovery of the U.S. tax authorities. Thus, to the defects in the formal structure of the taxation of capital must be added some very difficult enforcement problems relating to the same income.

40. There are at least a few exceptions to this generalization, however. Failure to index the basis of assets, and the existence of a separate, unintegrated corporate income tax are examples of features that tend in the direction of overtaxing income from capital.

41. See Moran & Whitford, *supra* note 1, at 763-72.

42. Note that Moran and Whitford did *not* find that employer-provided health insurance raised horizontal equity concerns. See *id.* at 787.

sought through the provisions in these categories generally are laudable. One wishes black taxpayers were in a position to take better advantage of those provisions, but that is not to say that even a black Congress would prefer an income tax that provided no incentives for home purchases or employer funding of pensions. Accordingly, Moran and Whitford's recommendations in these areas are modest and not wholly in keeping with their general emphasis on horizontal equity improvements.⁴³ Perhaps they should have explored more radical approaches to these problems, such as legislation that would employ means outside the tax system to expand home ownership and pensions.⁴⁴ But this assertion is meant more as a suggestion for future consideration than as a criticism of their article as written.

C. *Filing Status*

The final subject of Moran and Whitford's analysis is the so-called marriage penalty.⁴⁵ As is generally understood, under the current income tax rate structure, the rates applying to married couples filing joint returns are more favorable—compared to the rates that would have applied had the parties been able to file as single taxpayers—if one partner's income is very much larger than the other's. The rates are less favorable, however, than single returns would have been if the partners have roughly similar incomes.⁴⁶

43. As to home ownership, they argue for the use of credits with income caps. See *supra* note 7 (discussing this argument). As to employee benefits, they generally do not advocate changes, except for the suggestion that provisions authorizing 401(k) plans be repealed. See Moran & Whitford, *supra* note 1, at 790.

44. Recall that Stanley Surrey argued years ago that Congress ought generally to eschew use of the tax rules to provide incentives for taxpayers to behave in particular ways, even if the behavior was generally desirable. Although he was not describing black-white horizontal inequities, he did note the "windfalls" and "unfairness" that usually characterize the results of efforts to provide such incentives. See Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705, 734 (1970). In a following article, Professor Surrey specifically criticized the tax expenditures implicit in the rules regarding home ownership, suggesting that if they were to be replaced by direct appropriations, those appropriations would take a very different form from the subsidy embodied in the I.R.C. See Stanley S. Surrey, *Federal Income Tax Reform: The Varied Approaches Necessary to Replace Tax Expenditures with Direct Government Assistance*, 84 HARV. L. REV. 352, 395-408 (1970).

45. See Moran & Whitford, *supra* note 1, at 791-99.

46. Note that married couples can file separate returns. However, those separate returns are not taxed under the rate schedules prescribed for single taxpayers, but rather under a special—and quite unfavorable—schedule called "married, filing separately." In recent years, only about two percent of married taxpayers have filed separate returns, and many of those presumably have done so because their marriage has deteriorated to a

Moran and Whitford reviewed data on income distributions within families and concluded that black married couples were more likely than white couples to have roughly equal incomes, and hence to suffer more and larger marriage penalties.⁴⁷

Of course, one should remember in thinking about this issue that Congress did not enact marriage penalties and marriage bonuses *per se*. What Congress did enact is a system under which married taxpayers are taxed according to their total income, regardless of the similarity of, or disparity between, the two spouses' incomes. Suppose, for example, that A, a high-bracket taxpayer, marries B, an individual with no income. When A and B file a joint return, they will enjoy a lower tax bill than A would have paid on that income if she had remained single (that is, they will enjoy a marriage bonus). But the lower tax does no more than reflect congressional judgments about A's reduced economic circumstances and similarly reduced ability to pay tax. Two cannot in fact live as cheaply as one, so A's income will not go as far as it did when A was supporting only herself. The so-called marriage bonus, in other words, reflects a changed economic reality.

Conversely, suppose that C, a middle-bracket taxpayer, marries D, an individual with the same income. Their total tax as a married couple will likely exceed the sum of the tax bills they would have paid as single taxpayers (that is, they will suffer a marriage penalty). Again, however, the higher tax reflects an economic reality: Two cannot live as cheaply as one, but there are likely to be some efficiencies in forming a single household, such as preparing meals together, and so on.⁴⁸ It is thus not at all clear that there is any

point at which sharing financial data to complete a joint return has become problematic. In 1994, about 97 million married taxpayers filed joint returns, while fewer than 2.5 million filed separate returns. See INTERNAL REVENUE SERV., U.S. DEP'T OF THE TREASURY, *INDIVIDUAL INCOME TAX RETURNS 1994*, at 36-37 tbl.1.3 (1997) (providing figures on which author's calculations are based).

47. See Moran & Whitford, *supra* note 1, at 797. They note that in 1980, the average black wife contributed 29.5% of her family's income, while the average white wife earned only 18% of her family's total. See *id.* Both of these numbers are by now rather out of date, given the changes in the amount and type of labor force participation by women in the last 18 years. One thinks, to mention one example, of the much larger number of two-lawyer couples now in the labor force and now suffering marriage penalties, compared to what would have been the case in 1980.

48. The economies should not be exaggerated. They will vary widely and will not always be large. On the other hand, the marriage penalty is not large either. For example, in 1997, a couple with incomes of \$25,000 each would pay only \$356 more tax as filers of a joint return than they would have paid as two single taxpayers. Thus, if they can save as little as \$30 per month by reason of merging their households, they will not suffer at the hands of the marriage penalty on a net basis.

inequity in this statutory construct. Any two married couples with the same taxable income face the same tax rates, regardless of their race, and regardless of the mix of their incomes. Since it does not seem that either of these factors *should* bear on tax liabilities, one is hardly disturbed to learn that they in fact do not. To make the case that blacks are disadvantaged by this arrangement, one must assert that a married couple whose partners have roughly similar incomes is entitled to a lower tax bill than an otherwise identical married couple with a wider income split between them.

I question as well Moran and Whitford's decision to look at just one aspect of filing status, rather than looking at filing status questions more generally. If it is true, for example, that a disproportionate number of married African-Americans suffer marriage penalties, then it is probably also true that blacks as a group benefit from the fact that overall marriage rates are lower for blacks than for whites.⁴⁹ It may be worth noting as well that the ultimate antidote to an impending marriage penalty is to follow Nancy Reagan's advice (offered in a different context) to "just say 'no'" to a marriage proposal, but to go ahead and live together anyway. Data from the 1990 census suggest that this option is significantly more popular among African-Americans than among whites, and that too is presumably to the tax advantage of blacks.⁵⁰

Finally, some consideration might be given to the last set of tax rates applicable to individuals—those applying to "heads of households," a status available essentially to single parents. The tax rates applying to such taxpayers are distinctly lower (at all incomes below \$250,000) than the rates that would otherwise apply to single taxpayers. Again, 1990 census data suggest that a far higher proportion of African-Americans than of whites is eligible for head-

49. Sample data for 1996 suggest that about 56.7% of whites were living with their spouses, while only 31.0% of blacks were. See STATISTICAL ABSTRACT, *supra* note 3, at 58 tbl.64 (providing data on "Living Arrangements of Persons 15 Years Old and Over, by Selected Characteristics, 1996"). Living arrangements are a better measure for tax purposes than is actual marital status, since legally separated spouses are eligible to file as single taxpayers, and certain married individuals supporting dependents can file as heads of households if they are "considered unmarried," one of the qualifications for which is the substantial absence of the spouse.

50. About 10.2% of nonfamily households headed by white persons consisted of an unmarried man and woman living together. The comparable percentage for black households was 15.5%, a rate that is about 53% greater than the comparable rate for white households. See U.S. DEP'T OF COMMERCE, 1990 CENSUS OF POPULATION, SOCIAL AND ECONOMIC CHARACTERISTICS, at 51-52 tbls.51-52 (providing figures upon which author's calculations are based).

of-household status.⁵¹

Taken together, the facts that there are proportionately more African-Americans who are single parents, or single persons living with adults of the opposite sex, and more single persons overall, make it unlikely that blacks as a group are disadvantaged by the current filing status rules. This would be true even if one does think that the "marriage penalty" is a real equity problem, and not just a rallying cry of married couples who would like not to have their improved economic status (as married couples, enjoying the efficiencies associated with that status) reflected in their tax bills.

IV. CONCLUSIONS

As I noted at the outset, I first read Moran and Whitford's article skeptically. The federal income tax is certainly facially race-neutral. And the tax is progressive, which must greatly favor African-Americans in light of their significantly lower average incomes. I continue to believe that those things are true, and that the progressivity of the tax system is a far more important characteristic from an African-American viewpoint than are any of the characteristics Moran and Whitford consider in their article. Nevertheless, I must admit that I am tentatively persuaded that there really may be important features of the federal income tax that raise horizontal equity concerns along racial lines, which is, of course, Moran and Whitford's main point.

What can be done about those features is extremely problematic. They are primarily features having to do with home ownership and retirement savings—features that enjoy very broad support within Congress and among taxpayers of all races.⁵² It is difficult to imagine mustering political support for radical changes of these features within the context of a continued income tax regime. Moreover, it is

51. According to the Census, 12.2% of family households headed by whites consisted of households headed by females, with no husband present. *See id.* (providing figures for author's calculations). The comparable figure for black family households was 43.2%, a figure that is more than three and one-half times larger than the comparable white rate. *See id.* (providing figures for author's calculations).

52. These features are codified at I.R.C. § 163 (mortgage interest), § 164 (real property taxes), and §§ 401-417 (qualified plans). As noted above, *see supra* notes 39-40 and accompanying text, it is also probably the case that the tax system has a disparate impact unfavorable to blacks in its failure to tax income from capital as reliably as income from wages. The solutions in these areas, however, are far from obvious, since the defects stem largely from administrative considerations (such as the difficulty of annually appraising assets) or enforcement shortcomings (such as the difficulty of discovering foreign bank accounts).

not even clear that radical reform would be desirable, since these features accomplish non-tax goals that are generally regarded with high approbation.

Reform of these features might be imaginable within the context of a more general radical reform of the federal tax system—one that might include repeal of the existing income tax altogether. But it seems very likely that such a reform would involve a substitute tax that would be significantly less progressive than the current income tax, and this result would likely be much more powerfully disadvantageous to blacks than are the horizontal equity problems that may affect the current system.

Whether or not there is a good solution to this problem, Moran and Whitford deserve credit for raising a significant issue and for doing the difficult data analysis necessary to show, at least tentatively, that the federal income tax may well be infected by racially tinged horizontal equity problems heretofore unacknowledged.

